BEFORE THE STATE BGARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
C. H. AND VIVIAN MICHEL)

Appearances:

For Appellants: M. B. Kambel, Attorney at Law

For Respondent: Burl D. Lack, Chief Counsel;
Wilbur F. Lavelle, Assistant Counsel

O P I N I O M

This appeal is made pursuant to Section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protests of C. H. and Vivian Michel to proposed assessments of additional personal income tax in the amount of $3,212.20 against each Appellant for the year 1951.

Appellants are husband and wife. The husband operated a billiard establishment and, until October, 1951, conducted bookmaking activities (taking bets on horse races) on the premises.

Respondent determined that all deductions for bets lost and all deductions for the operating expense of the billiard business should be disallowed for the period from May 3, 1951, the effective date of Section 17359 of the Revenue and Taxation Code, to October, 1951, when the bookmaking activities ceased.

Section 17359 (now 17297) provided, in substance, that no deductions shall be allowed on income from certain defined illegal activities, or from activities that tend to promote or further or are associated or connected with the illegal activities. Bookmaking is one of the illegal activities so defined. (Penal Code §337a.)

The one question that is seriously pressed by Appellants is whether Respondent properly computed the amount of bets lost.

Appellants and Respondent begin at a common point, namely $30,187.80, representing net winnings, that is, bets won less bets lost during 1951. Respondent has derived the gross income of Appellants from betting in that year by dividing the above figure by .14. This is based on the experience of the California tracks, which return 86 percent? of the pari-mutuel pools and retain 14 percent. Respondent has reduced the resulting amount in a proportion designed to exclude betting transactions prior to the effective date of Section 17359.

Appellants do not have actual records but estimate that the net winnings represent approximately 45 percent of bets won. Appellants state that their income tax returns for 1947 and 1948 show an accurate breakdown of winning and losing bets, that the returns were filed at a time when Appellants had no reason to falsify, that these breakdowns substantiate Appellants' claim and that they constitute the best evidence of Appellants' actual betting experience. Appellants allege that they did not pay tracks odds and made a selection of bets to accept, resulting in a much more favorable betting experience than that of the public race tracks.

Although it is true that in the years 1947 and 1948 it was not advantageous to minimize detiuctions for bets lost, it was advantageous to minimize the amount of bets won, which would create a high ratio of losses to winnings. Furthermore, errors can arise from many causes of which intentional dishonesty is only one. Merely ruling out intentional dishonesty does not establish the correctness of the returns without evidence of the underlying records from which the returns were prepared or the methods used in compiling the information for the preparation of the returns. Neither Appellants nor their accountant testified in this proceeding. These considerations, coupled with the relative remoteness of those years to the year in question compel us to conclude that Appellants' evidence is unreliable. We must therefore accept Respondent's determination.

We shall briefly consider the following additional points that Appellants raised in their protest to Respondent, which was incorporated in this appeal by reference. Appellants did not elaborate on these points with facts or authorities.

1. Appellants contend that Respondent erroneously relied on Section 17297 rather than 17359, the section that was in effect during the period involved, This contention has no merit. The two sections are substantially identical. Section 17028, which was in effect when Section 17297 was adopted, provides that "The provisions of this code in so far as they are substantially the same as existing statutory provisions relating to the same subject matter shall be construed as restatements and continuations thereof, and not as new enactments."

2. Appellants contend that an assessment under either section would be unlawful unless the fact of the illegal activities had been established beyond a reasonable doubt and in a court of competent jurisdiction. We cannot accept this proposition in the absence of authority to support it. Appellants have not denied the existence of the illegal activities and have, in fact, admitted them in the course of their presentation on the main question.

3. Appellants contend that "payouts" must be offset to arrive at gross income. This point was settled against Appellants' position in Hetzel v. Franchise Tax Board, 161 Cal. App. 2d 224.

4. Appellants contend that the billiards business did not tend to promote or further, nor was it associated or connected with, any illegal activity. As a prima facie matter, the undisputed fact that the billiards business and the bookmaking activities were conducted on the same premises is indicative of the relationship between them. Appellants, who are in a position to know the situation, have not presented any evidence to the contrary. We thus conclude that the expenses of the billiard business were properly disallowed under Section 17359.

5. Appellants contend, finally, that Section 17359 was unconstitutional. It is our well-established policy not to pass on the constitutionality of a statute in an appeal such as this, but it may be observed that the constitutionality of this section as applied to a bookmaker was upheld in Hetzel v. Franchise Tax Board, supra.

O R D E R

Pursuant to the views expressed in the Opinion of the Board on file in this proceeding, and good cause appearing therefor.,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to Section 18595 of the Revenue and Taxation Code that the action of the Franchise Tax Board on the protests of C. H. and Vivian Michel to proposed assessments of additional personal income tax in the amount of $3,212.20 against each Appellant for the year 1951, be and the same is hereby sustained.

Done at Sacramento, California, this 2nd day of May, 1961, by the State Board of Equalization.

John W. Lynch, Chairman

Geo. R. Reilly, Member

Paul R. Leake, Member

_____, Member

_____, Member

ATTEST: Dixwell L. Pierce, Secretary